IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 101 of 1985

For Approval and Signature:

Hon'ble CHIEF JUSTICE MR DM DHARMADHIKARI
and
Hon'ble MR.JUSTICE M.S.SHAH

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

COMMISISONER OF INCOME-TAX

Versus

COMMERCIAL A'BAD MILLS CO.LTD.

Appearance:

MR AKIL KURESHI FOR MR RP BHATT for Petitioner
SERVED BY RPAD - (N) for Respondent No. 1
MR MANISH J SHAH - AMICUS CURIE

CORAM : CHIEF JUSTICE MR DM DHARMADHIKARI
and
MR.JUSTICE M.S.SHAH

Date of decision:27/12/2000

C.A.V. JUDGEMENT

(Per : CHIEF JUSTICE MR DM DHARMADHIKARI)

#. In the case of present assessee the Commercial Ahmedabad Mills Company Ltd., Ahmedabad, for the assessment year 1975-76, at the instance the Revenue, the following question of law has been referred to this Court under Section 256(1) of the Income Tax Act:

"Whether in the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that the amount of gratuity includible for disallowance under Section 40(c) of the Act would be the excess of the amount which is exempt under Section 10(10) of the Act?"

#. A sum of Rs.10,500/- was payable to one of the Managing Directors, who retired at the end of the accounting year. The assessing Authority and the Commissioner of Income Tax (Appeals) treated the said amount as part of salary and hence not deductible in computing the income chargeable under the head `profits and gains of business or profession' in accordance with Section 40(c) of the Act.

#. The Income Tax Appellate Tribunal, however, came to the conclusion on the basis of its own decision in SAPT Textiles Ltd. 7 Taxman 40 Bom. that the amount paid on retirement to the Managing Director can be treated as gratuity and would be deductible under Section 40(c) of the Act but only to the extent it is in excess of what is exempt under Section 10(10) of the Act.

#. On behalf of the Revenue, learned counsel Shri Akil Kureshi contends that the Tribunal was clearly in error in holding that by virtue of provisions contained in Section 10(10) of the Act, the amount of gratuity paid or payable to the Managing Director on his retirement in excess of the prescribed limit in Section 10(10)(iii) of the Act was only liable to be held as not deductible under Section 40 of the Act. The further contention advanced on behalf of the Revenue is that the lump sum amount paid or payable to the Managing Director on retirement was neither `gratuity' within the meaning of Section 10(10) nor `any expenditure resulting directly or indirectly in the provision of any remuneration, benefit or amenity' to a Managing Director within the meaning of subclause (i) of clause (c) of Section 40 of the Act, and therefore, the whole amount was not deductible in computing the income of the assessee company.

#. Since the amount involved is small, the respondent

assessee is not represented. On our request learned counsel Mr. Manish J. Shah appeared as amicus curie and we thankfully acknowledge his assistance to the Court. Learned Counsel Mr. Manish J. Shah brought to our notice the decisions of Calcutta High Court and two decisions of Bombay High Court, to which we shall shortly make a reference.

#. For answering the question referred, it is necessary to examine the relevant provisions of the Act. Section 40 contains description of such amounts which are not deductible in computing the income chargeable under the Head "profits and gains of business or profession'. The relevant provision contained in clause (c) of Section 40 as existed at the relevant time reads:-

"40. Notwithstanding anything to the contrary in sections 30 to 39, the following amounts shall not be deducted in computing the income chargeable under the heard "Profits and gains of business or profession", -

(a) in the case of any assessee -

xx xxx xx xxx xx

(b) xx xxx xx xxx xx

(c) in the case of any company -

(i) any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to a director or to a person who has a substantial interest in the company or to a relative of the director or of such person, as the case may be,

(ii) any expenditure or allowance in respect of any assets of the company used by any person referred to in sub-clause (i) either wholly or partly for his own purposes or benefit,

if in the opinion of the Income-tax Officer any such expenditure or allowance as is mentioned in sub-clauses (i) and (ii) is excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom, so, however, that the deduction in respect of the aggregate of such expenditure and allowance in respect of any one person referred to in sub-clause (i) shall, in no case, exceed -

(A) where such expenditure or allowance relates to a period exceeding eleven months comprised in the previous year, the amount of seventy-two thousand rupees;

(B) where such expenditure or allowance relates to a period not exceeding eleven months comprised

in the previous year, an amount calculated at the rate of six thousand rupees for each month or part thereof comprised in that period;

Provided that in a case where such person is also an employee of the company for any period comprised in the previous year, expenditure of the nature referred to in clauses (i), (ii), (iii) and (iv) of the second proviso to clause (a) of sub-section (5) of section 40A shall not be taken into account for the purposes of sub-clause (A) or sub-clause (B), as the case may be.

Explanation: The provisions of this clause shall apply notwithstanding that any amount not to be allowed under this clause is included in the total income of any person referred to in sub-clause (i);"

#. The other relevant provision is Section 10 which contains description of items not included in total income. The Section reads :

"10. In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included -

(1) to (9) xx xxx xx xxx xx

(10) (i) xx xxx xx xxx xx

(ii) xx xxx xx xxx xx

(iii)any other gratuity received by an employee on his retirement or on his becoming incapacitated prior to such retirement or on termination of his employment, or any gratuity received by his widow, children or dependents on his death, to the extent it does not, in either case, exceed one-half month's salary for each year of completed service, calculated on the basis of the average salary for the three years immediately preceding the year in which the gratuity is paid, subject to a maximum of thirty thousand rupees or twenty months' salary so calculated, whichever is less:"

#. From the record of the proceedings before the tax Authorities and the statement of case of the Tribunal it is not made clear that the sum of Rs. 10,500/- found payable to one of the Managing Directors was by way of a lump sum gratuity amount. What can be assumed from the statement of case is that a sum of Rs. 10,500/- was found payable to the Managing Director on his retirement. The provision of Section 10 state that certain specified amounts shall not be included in the total income of the

person. Section 10 which excludes from computation of total income the amount of gratuity to the specified limit of Rs. 30,000/- or 20 months' salary is an amount not includible in the income of the Managing Director as the person who has received that income. Section 10 cannot be availed by the assessee company which has paid that lump sum amount on retirement of the Managing Director. Section 10, therefore, is wholly irrelevant for deciding the question referred. The only relevant Section is Section 40(c). In the opinion of the Tribunal, the lump sum payment of Rs. 10,500/- made by the assessee company to the Managing Director can be treated to be "an expenditure which results directly or indirectly in the provisions of any remuneration or benefit or amenity to the director" and is, therefore, not deductible from the income of the assessee chargeable under the head "profits and gains of business or profession". It is deductible only to the extent the amount is not in excess of Rs. 22,000/- as provided in sub-clause (A) of said clause (c) of Section 40.

#. The Tribunal in coming to the above conclusion has referred to its own decision in SAPT Textiles. The opinion of the Tribunal also finds support from the decision of the High Court of Calcutta in Indian Oxygen Limited v. Commissioner of Income-Tax (1987) 164 ITR 466.

##. Learned counsel appearing as amicus curie brings to our notice the decision of Bombay High Court in the case of Commissioner of Income-Tax v. Colgate Palmolive (India) Pvt. Ltd. (1994) 210 ITR 770, which has been followed in subsequent decision by the Bombay High Court itself by the same Bench in SAPT Textile Produces (India) Ltd. v. Commissioner of Income-Tax (1996) 217 ITR 378. The High Court of Bombay on a similar item of expenditure incurred by the assessee company in making a lump sum payment to its director on retirement, came to the conclusion that one time payment in the nature of retirement gratuity is not salary as defined under Explanation 2 to Section 40A(5). The Bombay High Court in the case of Colgate Palmolive (supra) observes:

"The second fallacy in this argument consists in considering the payment of gratuity at the time of retirement of an employee director as falling only under section 40(c) and/or section 40A(5), i.e., as a periodic payment relatable to any specific year of service. Gratuity which is paid at the time of retirement tis undoubtedly paid on the basis of the entire length of service of an

employee. But it cannot be apportioned yearwise to each of the years in question. For example, unless an employee completes a certain minimum period of service, he will not be eligible for gratuity. Secondly, the calculation of gratuity may depend upon the salary drawn by an employee at the time of his retirement and not on the basis of his salary in any specific year. Therefore, payment of gratuity at the time of retirement cannot be equated with a monthly or yearly payment of salary or monthly allowance.

..... gratuity cannot be looked upon as periodic payment, it is not covered by the provisions of either section 40(c) or section 40A(5) of the Income-Tax Act, 1961. The ceiling, therefore, which is prescribed under these two sections on allowable expenditure will not apply to this payment."

##. The Bombay High Court in the case of Colgate Palmolive (supra) having thus held that lump sum payment by way of gratuity at the time of retirement to an employee or director, being not a periodic payment, will not be covered by Section 40(c) or Section 40A(5) for the purpose of applying the ceiling thereon. It held that such expenditure is deductible in general provision contained in Section 37 of the Act. Under Section 37 which is a general provision, any `expenditure laid out or expended wholly and exclusively for the purposes of the business or profession' barring the expenditure of specific types prescribed in the Section shall be allowed in computing the income chargeable under the head "profits and gains of business or profession". The decision of Colgate Palmolive (supra) was followed in SAPT Textiles (supra) and it is only a matter of guess whether the same judgment of the Tribunal in SAPT Textiles (supra) which has been relied by the Tribunal in this case was the subject matter of decision by the Bombay High Court in the case reported in (1996) 217 ITR 378.

##. After considering the provisions referred in the order of the Tribunal and in the decisions discussed above, we find ourselves in full agreement with the view expressed by the Division Bench of the Bombay High Court in Colgate Palmolive case (supra). In the instant case, a lump sum payment of Rs. 10,500/- was made to Managing Director on his retirement. It is not clear whether it was paid by way of gratuity or some other kind of terminal benefit. It was certainly not a periodic payment to which the ceiling provided in subclauses (a)

and (B) of clause (c) of Section 40 could be applied. Such a one-time-lump-sum payment to director on his retirement, being not a periodic payment towards any remuneration, benefit or amenity, falls outside clause (c) of Section 40, and therefore, the Tribunal was in error in applying the provisions of clause (c) of Section 40 for coming to the conclusion that the amount in excess of the limit prescribed in subclause (A) of clause (c) of Section 40 is an amount not deductible for computation of income. We find ourselves in respectful agreement with the opinion of Division Bench of the Bombay High Court expressed in the case of Colgate Palmolive (supra) that such lump sum payment to the director at the time of his retirement can be claimed only as an expenditure under general provision contained in Section 37 being one `laid out or expended wholly and exclusively for the purpose of business or profession'. It can however be allowed only on fulfillment of the conditions contained in the provisions of the said Section.

##. As a result of the discussion aforesaid, we answer the question as under:-

In the facts and circumstances of the case, the amount paid on retirement to the director was not includible for disallowance under Section 40(c) to the extent of it being in excess of the amount under Section 10(10)(iii) of the Act, but such amount could be claimed by the assessee as expenditure under the general provision of Section 37 of the Act.

The question referred to above is, therefore, answered accordingly.

The Reference is disposed of accordingly. In the circumstances, there shall be no order as to costs.

(D.M. DHARMADHIKARI, C.J.)

(M.S. SHAH, J)

[sndevu]